

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Rev. & Tax. Committee Analyst: Kimberly Pantoja Bill Number: SB 2176

Related Bills: See Legislative History Telephone: 845-4786 Introduced Date: 02/25/2000

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: LAMBRA & MEA Hiring Credit Vouchering Requirement/Information, Individual & Fiduciary Returns/Partial Conformity of Exempt Law/Technical Changes

SUMMARY

This Franchise Tax Board sponsored bill would:

- Ⓟ Amend and restructure a significant number of tax laws, particularly those regarding information returns, exempt organizations, unpaid interest and deficiencies, to more closely conform to federal law by referencing the federal code rather than duplicating its language. The bill also would make other technical changes (e.g. section cross-reference corrections). See Conformity/Restructure and Technical Changes on page 2.
- Ⓟ Add a vouchering requirement to the Local Agency Military Base Recovery Area (LAMBRA) and Manufacturing Enhancement Area (MEA) hiring credits consistent with the vouchering requirement in the enterprise zone hiring credit. See Hiring Credit Vouchering on page 5.

LEGISLATIVE HISTORY

AB 2892 (2000) contains provisions identical to the information return, interest, and individual and fiduciary return provisions contained in this bill. AB 2893 (2000) contains provisions identical to the conformity of exempt law provisions contained in this bill. AB 2895 (2000) contains provisions identical to the LAMBRA and MEA hiring credit vouchering provisions contained in this bill. AB 2897 (2000) contains provisions identical to the technical provisions contained in this bill.

FISCAL IMPACT

Departmental Costs

No departmental costs are associated with this bill.

Tax Revenue Estimate

This bill would not impact state tax revenue.

BOARD POSITION

Support.

On December 16, 1999, the Franchise Tax Board voted to sponsor the language contained in this bill.

Board Position:

| | | |
|------------------|-------------------|-----------------------|
| <u> X </u> S | <u> </u> NA | <u> </u> NP |
| <u> </u> SA | <u> </u> O | <u> </u> NAR |
| <u> </u> N | <u> </u> OUA | <u> </u> PENDING |

Department Director

Date

Alan Hunter for GHG

4/4/00

1. Conformity/Restructure and Technical Changes

EFFECTIVE DATE

This bill would be effective January 1, 2001. Provisions affecting the imposition or computation of tax, certain additions to tax, penalties, or the allowance of credits would be operative for taxable or income years beginning on or after that date. Other provisions would be operative on and after that date.

SPECIFIC FINDINGS

While the **Personal Income Tax Law** (PITL) and much of **Bank and Corporation Tax Law** (B&CTL) are conformed to the IRC by direct reference, the **Administration of Franchise and Income Tax Law** (AFITL) contains primarily stand-alone state language. However, in most cases, the stand-alone language is the same as federal law.

Although the legal effects of federal and state laws regarding some provisions are the same, the language contained in the Revenue and Taxation Code (RTC) differs from the language contained in the IRC. This difference can cause confusion in certain circumstances, especially with tax practitioners familiar with federal law.

Over time, California law has a tendency to drift away from federal law. This often creates unintended differences and, in general, makes it more difficult for the Franchise Tax Board (FTB) to rely on federal law, regulations, and court decisions in carrying out its administrative duties under the Revenue and Taxation Code (RTC). Taxpayers face similar problems in complying with the law. Also, without constant examination of the state law, obsolete and unnecessary provisions may begin to clutter the RTC, making the law more difficult to understand for taxpayers, practitioners, and the department.

This bill would amend several sections of state law to conform more closely to the language and structure of the IRC. Some separately stated provisions would be replaced with a direct reference to the federal statute.

This bill also would eliminate obsolete provisions and make necessary technical changes.

Current federal law provides that an individual taxpayer must file an income tax return if his gross income equals or exceeds a specified amount. Married taxpayers may file a joint return. Corporations, trusts and estates also must file income tax returns. A partnership files an information return of income. Payors and others must file information returns to report specified payments, sales, etc. Times, places and methods of paying tax are specified.

Current state law provides, in general, that every individual (or fiduciary) shall file an income tax return with FTB for each taxable year, and the RTC contains specific rules relating to threshold requirements, due dates, extensions, filing status, and changes in filing status.

California law generally follows federal law by requiring businesses to file information returns reporting payments made by or to other persons. This information is matched against income tax returns and generally used for purposes of identifying taxpayers who have under-reported or failed to report amounts received as income and to verify certain deductions claimed on their return.

Article 4 of Chapter 2 of Part 10.2 (commencing with Section 18631) of the AFITL contains provisions similar to the provisions of Part III of Chapter 61 of Subtitle F of the IRC relating to information returns. Although the organization of the state provisions generally follows the organizational sequence of the IRC, the differences in organization and separately stated provisions make state law difficult to understand in relation to federal law, even in areas in which the two are substantially the same.

This bill would consolidate many filing requirements for individuals and fiduciaries into the same section and repeal numerous sections of law that currently set forth a separate filing requirement. This would clarify that in most cases a copy of the federal information return satisfies the state-reporting requirement.

This bill also would increase the filing requirement threshold amounts for fiduciaries to match the threshold amounts for individuals.

Current federal law, IRC Section 6601, requires that interest be assessed at a specified rate on all underpayments or deficiencies from the last date prescribed for payment, until paid.

California law is generally in conformity with federal law as it relates to the assessment of interest on underpayments and deficiencies. However, California law conforms to federal law by stand-alone language and uses six code sections to do so.

This bill would consolidate code sections relating to interest on unpaid tax and deficiencies similar to the structure in the IRC.

Existing state law requires interest to be assessed upon any tax deficiency. The interest is assessed, collected, and paid in the same manner as the tax deficiency itself and is calculated at a rate which is adjusted annually. Interest is imposed from the date that the tax was required to be paid or, if the tax is paid in installments, from the date prescribed for payment of the first installment, until the date the tax is paid.

Existing state law also requires the assessment of interest on any tax refund or credit that the FTB makes or allows and later determines to be erroneous. For an erroneous refund, the FTB must provide notice and demand for repayment within two years after the refund or credit is issued or during the period within which the FTB may mail a notice of proposed deficiency assessment, whichever time period ends later. Under this section, interest on erroneous refund or credit amounts does not begin accruing until 30 days from the date the FTB mails the notice and demand for repayment.

Existing state law allows the FTB to recover any erroneous refund or credit, and any related interest, in a court action. However, the section that allows this court action specifies both that interest is calculated from the date the FTB mails the notice and demand for repayment and that for corporations, interest must be calculated from the date the refund was made or the credit allowed.

The **existing state law** regarding the computation of interest with respect to a court action is in conflict with the more general state law that describes when the calculation of interest begins on an erroneous refund amount. The department's current practice is to follow the state law, which allows 30 days from the date of notice and demand before beginning to accrue interest, rather than accruing interest from the day the notice is mailed or from when the erroneous refund or credit amount was made or allowed. Under current practice, interest on erroneous refunds to individuals and corporations is calculated in the same manner.

This bill would clarify that interest on erroneous refund amounts begins to accrue 30 days from the date of notice and demand for repayment.

This bill also would delete a subdivision that addresses how interest will accrue for corporations on amounts that were erroneously made or allowed when an action is brought to court.

Current federal law in IRC Section 501 lists the various types of organizations that are exempt from taxation under federal law. IRC Section 502 defines a "feeder organization." IRC Section 504 provides for the status of an organization after it ceases to qualify for exempt status because of substantial lobbying or political activities. IRC Section 4911 imposes an excise tax on exempt organizations that expend a specified excess amount for the purpose of influencing legislation.

Current state law, in RTC Sections 23701a through 23701z, lists the various organizations that, upon application and approval by the FTB, are exempt from taxation under the B&CTL. The descriptions of 15 different organizations exempt from tax under California law are, with minor exceptions, the same as the descriptions of 15 organizations exempt from tax under federal law. RTC Section 23702 is substantially the same as IRC Section 502, which defines a "feeder organization." RTC Section 23704.6 is substantially the same as IRC Section 504 relating to the status of an organization no longer exempt because of its political lobbying activities. RTC Section 23740 uses definitions contained in IRC Section 4911, but does not conform to the excise tax imposed on excess expenditures to influence legislation. California's conformity to the above items is through "stand-alone" language that is substantially the same as parallel provisions of federal law.

This bill would conform California exempt organization terms and concepts to the IRC exempt organizations statutes by reference to the federal sections and subsections. This bill would preserve the present law differences between state and federal exempt law. The net effect would not change the present California exempt terms and concepts.

Policy Considerations

This bill would increase the filing requirement threshold amounts for fiduciaries to match the threshold amounts for individuals. The current amounts require fiduciaries who do not have a tax liability to file a return. Increasing the threshold amounts would eliminate the need for those taxpayers to file a return and decrease the number of returns processed by the department.

Conforming to federal tax law is generally desirable because it is less confusing for the taxpayer. With conformity, the taxpayer is required to know only one set of rules. Conformity also eases FTB's administration of the law by utilizing many federal forms and instructions. It allows the department to increase use of federal regulations, rulings, and court decisions when administering provisions of the RTC. Reliance upon federal regulations, rulings, and court decisions helps to reduce the number of protests and appeals and enables the department to resolve protests and appeals quicker at less cost. Also, elimination of obsolete and unnecessary provisions makes the law easier to read for the taxpayers and the department.

Implementation Considerations

This bill would assist the department's programs and operations by easing administration of the tax law. Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the department's normal annual update.

Technical Considerations

Amendments are provided to resolve the following concerns:

- Ⓟ Amendments 4 and 12 would correct typographical errors.
- Ⓟ Amendment 5 would delete a repeated word.
- Ⓟ Amendment 6 would capitalize "internal."
- Ⓟ Amendment 7 would correct a reference.
- Ⓟ Amendments 8 and 10 would prevent the inadvertent moving of an interest section (in Article 1) to the refund article (Article 2).
- Ⓟ Amendment 9 would make a change to reflect changes made in Section 37 of this bill to Section 19411 of the R&TC. Without this amendment, Section 35 and Section 37 of the bill would conflict.
- Ⓟ Amendment 11 would repeal an existing law section that is being added in Section 52 of the bill. This was inadvertently omitted during drafting.
- Ⓟ Amendment 13 would correct a cross-reference.

2. Hiring Credit Vouchering

EFFECTIVE DATE

This bill would be effective January 1, 2001, and operative for qualified disadvantaged individuals and qualified displaced employees hired on or after January 1, 2001.

PROGRAM HISTORY/BACKGROUND

California has four types of economic development areas (EDA) that have similar tax incentives:

- Ⓟ Enterprise Zones,
- Ⓟ Local Agency Military Base Recovery Areas (LAMBRA),
- Ⓟ Targeted Tax Area (TTA), and
- Ⓟ Manufacturing Enhancement Areas (MEA)

SPECIFIC FINDINGS

Under existing state law, taxpayers operating in any of the EDAs are allowed a hiring credit for employing "qualified employees." "Qualified employees" for all EDAs generally are defined by reference to various state and federal employment assistance programs.

Existing enterprise zone and TTA statutes require taxpayers to obtain vouchers for new employees. The voucher is issued by a federal or state agency familiar with the various employment assistance statutes and certifies that the prospective employee is qualified for or is receiving public assistance.

Existing LAMBRA and MEA statutes do **not** require taxpayers to obtain a voucher to be eligible for the hiring credit.

This bill would amend the LAMBRA and the MEA hiring credit statutes to be consistent with the existing enterprise zone and TTA statutes by requiring taxpayers to obtain a voucher for new employees.

Implementation Considerations

Since the Trade and Commerce Agency (TCA) already administers the LAMBRA and MEA programs as though there were a vouchering requirement for the hiring credit, implementing this bill would not significantly affect the department's programs and operations.

Technical Considerations

Amendments are provided to resolve the following technical concerns:

- ⌚ Amendment 1 would insert language omitted during drafting of this bill.
- ⌚ Amendment 2 would delete unnecessary language.
- ⌚ Amendment 3 would correct an error made when the section was renumbered.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 2176
As Introduced February 25, 2000

AMENDMENT 1

On page 8, modify line 34 as follows:

provides that a qualified disadvantaged individual or qualified displaced employee meets

AMENDMENT 2

On page 17, modify lines 6 and 7 as follows:

provides that a qualified disadvantaged individual ~~or qualified displaced employee~~ meets the eligibility

AMENDMENT 3

On page 21, line 4, strikeout "(i)" and insert:

(h)

AMENDMENT 4

On page 26, line 15, strikeout "make" and insert:

made

AMENDMENT 5

On page 27, line 14, strikeout "of" the second time it appears.

AMENDMENT 6

On page 31, line 10, strikeout "internal" and insert:

Internal

AMENDMENT 6.5

On page 36, line 38, strikeout "of part II" and insert:

of Part II

AMENDMENT 7

On page 36, line 39, strikeout "69" and insert:

68

AMENDMENT 8

Strikeout page 47, line 30 through page 49, line 35, inclusive, and insert:

SEC. 30. Section 19104 of the Revenue and Taxation Code is amended to read:

19104. (a) ~~Interest upon the amount assessed as a deficiency shall be assessed, collected, and paid in the same manner as the tax at the adjusted annual rate established pursuant to Section 19521 from the date prescribed for the payment of the tax or, if the tax is paid in installments, from the date prescribed for payment of the first installment, until the date the tax is paid. If any portion of the deficiency is paid prior to the date it is assessed, interest shall accrue on that portion only to the date paid.~~

~~(b) If the Franchise Tax Board makes or allows a refund or credit that it determines to be erroneous, in whole or in part, the amount erroneously made or allowed may be assessed and collected after notice and demand pursuant to Section 19051 (pertaining to mathematical errors), except that the rights of protest and appeal shall apply with respect to amounts assessable as deficiencies without regard to the running of any period of limitations provided elsewhere in this part. Notice and demand for repayment must be made within two years after the refund or credit was made or allowed, or during the period within which the Franchise Tax Board may mail a notice of proposed deficiency assessment, whichever period expires the later. Interest on amounts erroneously made or allowed shall not accrue until 30 days from the date the Franchise Tax Board mails a notice and demand for repayment as provided by this subdivision.~~

~~(c) In the case of any assessment of interest, the Franchise Tax Board may abate the assessment of all or any part of that interest for any period in any of the following circumstances:~~

~~(A) (1) Any deficiency attributable in whole or in part to any unreasonable error or delay by an officer or employee of the Franchise Tax Board (acting in his or her official capacity) in performing a ministerial or managerial act.~~

~~(B) (2) Any payment of any tax described in Section 19033 to the extent that any delay in that payment is attributable to that officer or employee being dilatory in performing a ministerial or managerial act.~~

~~(C) (3) Any interest accruing from a deficiency based on a final federal determination of tax, for the same period that interest was abated on the related federal deficiency amount under Section 6404(e) of the Internal Revenue Code, and the error or delay occurred on or before the issuance of the final federal determination. This subparagraph shall apply to any ministerial act for which the interest accrued after September 25, 1987, or for any managerial act applicable to a taxable or income year beginning on or after January 1, 1998, for which the Franchise Tax Board may propose an assessment or allow a claim for refund.~~

~~(D) (4) For purposes of this paragraph:~~

~~(i) (A) Except as provided in subparagraph (C), an error or delay shall be taken into account only if no significant aspect of that error or delay can be~~

attributed to the taxpayer involved and after the Franchise Tax Board has contacted the taxpayer in writing with respect to that deficiency or payment.

~~(ii)~~ (B) Within 180 days after the Franchise Tax Board mails its notice of determination not to abate interest, a taxpayer may appeal the Franchise Tax Board's determination to the State Board of Equalization. The State Board of Equalization shall have jurisdiction over the appeal to determine whether the Franchise Tax Board's failure to abate interest under this section was an abuse of discretion, and may order an abatement. This subparagraph is operative for requests for abatement made on or after January 1, 1998.

~~(iii)~~ (C) Except for subparagraph (B), ~~the amendment adding clause (ii)~~, the amendments made by Chapter 600, Laws 1997, are operative with respect to taxable or income years beginning on or after January 1, 1998. ~~The amendment adding clause (ii) is operative for requests for abatement made on or after January 1, 1998.~~

~~(2)~~ (b) The Franchise Tax Board shall abate the assessment of all interest on any erroneous refund for which an action for recovery is provided under Section 19411 until 30 days after the date demand for repayment is made, unless either of the following has occurred:

~~(A)~~ (1) The taxpayer (or a related party) has in any way caused that erroneous refund.

~~(B)~~ (2) That erroneous refund exceeds fifty thousand dollars (\$50,000).

AMENDMENT 9

On page 51, ~~strikeout~~ lines 22 through 24, inclusive, and insert:

19521 from the date that is 30 days after the Franchise Tax Board mails a notice and demand for repayment.

AMENDMENT 10

On page 53, between lines 34 and 35, insert the following:

SEC. 36.5. Section 19368 is added to the Revenue and Taxation Code to Read: 19368. If the Franchise Tax Board makes or allows a refund or credit that it determines to be erroneous, in whole or in part, the amount erroneously made or allowed may be assessed and collected after notice and demand pursuant to Section 19051 (pertaining to mathematical errors), except that the rights of protest and appeal shall apply with respect to amounts assessable as deficiencies without regard to the running of any period of limitations provided elsewhere in this part. Notice and demand for repayment must be made within two years after the refund or credit was made or allowed, or during the period within which the Franchise Tax Board may mail a notice of proposed deficiency assessment, whichever period expires the later. Interest on amounts erroneously made or allowed shall not accrue until 30 days from the date the Franchise Tax Board mails a notice and demand for repayment as provided by this subdivision.

AMENDMENT 10.5

On page 54, ~~strikeout~~ lines 2 and 3, and insert:

in accordance with subdivision (b) of Section 19104, in an action brought

AMENDMENT 11

On page 76, between lines 6 and 7 insert the following:

SEC. 51.5. Section 23701i of the Revenue and Taxation Code is repealed.

~~23701i. Voluntary employees' beneficiary organizations providing for the payment of life, sick, accident, or other benefits to the members of such organization or their dependents or designated beneficiaries, if no part of their net earnings inures (other than through such payments) to the benefit of any private shareholder or individual.~~

AMENDMENT 12

On page 84, line 27, strikeout "pubic" and insert:

public

AMENDMENT 13

On page 88, line 13, strikeout "501a(c)(3)" and insert:

501(c)(3)